

Edgar Filing: TECHNITROL INC - Form 10-Q

TECHNITROL INC
Form 10-Q
November 07, 2002

Exhibit Index
is on page 38

UNITED STATES
SECURITIES & EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

For the quarterly period ended September 27, 2002, or

Transition Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

For the transition period from _____ to _____.

Commission File No. 1-5375

TECHNITROL, INC.
(Exact name of registrant as specified in Charter)

PENNSYLVANIA
(State or other jurisdiction of
incorporation or organization)

23-1292472
(IRS Employer
Identification Number)

1210 Northbrook Drive, Suite 385
Trevose, Pennsylvania
(Address of principal executive offices)

19053
(Zip Code)

Registrant's telephone number, including area code: 215-355-2900

Indicate by check mark whether the registrant (1) has filed all reports required
to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during
the preceding 12 months (or for such shorter period that the registrant was
required to file such reports), and (2) has been subject to the filing
requirements for at least the past 90 days. YES NO

Common Stock - Shares Outstanding as of November 1, 2002: 40,126,319

Page 1 of 41

PART I. FINANCIAL INFORMATION

Item 1: Financial Statements

Technitrol, Inc. and Subsidiaries

Consolidated Balance Sheets

September 27, 2002 and December 28, 2001
In thousands

Edgar Filing: TECHNITROL INC - Form 10-Q

| Assets | September 27, 2002 ----- (unaudited) | December 28, 2001 ----- |
|---|---|-------------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 200,150 | \$ 142,267 |
| Trade receivables, net | 66,189 | 63,294 |
| Inventories | 58,134 | 62,404 |
| Prepaid expenses and other current assets | 13,175 | 18,785 |
| | ----- | ----- |
| Total current assets | 337,648 | 286,750 |
| Property, plant and equipment | 163,826 | 170,665 |
| Less accumulated depreciation | 95,888 | 87,613 |
| | ----- | ----- |
| Net property, plant and equipment | 67,938 | 83,052 |
| Deferred income taxes | 10,576 | 9,499 |
| Excess of cost over total net assets acquired and other intangibles, net | 101,279 | 128,512 |
| Other assets | 26,687 | 17,207 |
| | ----- | ----- |
| | \$ 544,128 | \$ 525,020 |
| | ===== | ===== |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Current installments of long-term debt | \$ 9,988 | \$ 122 |
| Accounts payable | 23,407 | 24,780 |
| Accrued expenses | 75,495 | 72,591 |
| | ----- | ----- |
| Total current liabilities | 108,890 | 97,493 |
| Long-term liabilities: | | |
| Long-term debt, excluding current installments | 5,493 | 89,007 |
| Other long-term liabilities | 10,448 | 9,289 |
| Shareholders' equity: | | |
| Common stock and additional paid-in capital | 206,984 | 70,184 |
| Retained earnings | 216,427 | 264,055 |
| Other | (4,114) | (5,008) |
| | ----- | ----- |
| Total shareholders' equity | 419,297 | 329,231 |
| | ----- | ----- |
| | \$ 544,128 | \$ 525,020 |
| | ===== | ===== |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Page 2 of 41

Technitrol, Inc. and Subsidiaries
Consolidated Statements of Earnings
(Unaudited)
In thousands, except per share data

Edgar Filing: TECHNITROL INC - Form 10-Q

| | Three Months Ended | |
|---|---------------------------|---------------------------|
| | Sept. 27, 2002 ---- | Sept. 28, 2001 ---- |
| Net sales | \$ 103,626 | \$ 100,846 |
| Costs and expenses: | | |
| Cost of sales | 77,725 | 78,693 |
| Selling, general and administrative expenses | 22,311 | 23,732 |
| Restructuring and unusual and infrequent items | 876 | 8,808 |
| | ----- | ----- |
| Total costs and expenses applicable to sales | 100,912 | 111,233 |
| | ----- | ----- |
| Operating profit (loss) | 2,714 | (10,387) |
| Other (expense) income: | | |
| Interest income (expense), net | 140 | (10) |
| Other | 185 | 496 |
| Equity earnings of minority-owned investments | 189 | 106 |
| | ----- | ----- |
| Total other income (expense) | 514 | 592 |
| | ----- | ----- |
| Earnings (loss) before taxes and cumulative effect of accounting change | 3,228 | (9,795) |
| Income taxes (benefit) | 1,105 | (611) |
| | ----- | ----- |
| Net earnings (loss) before cumulative effect of accounting change | 2,123 | (9,184) |
| Cumulative effect of accounting change, net of income taxes | -- | -- |
| | ----- | ----- |
| Net earnings (loss) | \$ 2,123 | \$ (9,184) |
| | ===== | ===== |
| Basic earnings (loss) per share before cumulative effect of accounting change | \$ 0.05 | \$ (0.27) |
| Cumulative effect of accounting change, net of income taxes | -- | -- |
| | ----- | ----- |
| Basic earnings (loss) per share | \$ 0.05 | \$ (0.27) |
| | ===== | ===== |
| Diluted earnings (loss) per share before cumulative effect of accounting change | \$ 0.05 | \$ (0.27) |
| Cumulative effect of accounting change, net of income taxes | \$ -- | \$ -- |
| | ----- | ----- |
| Diluted earnings (loss) per share | \$ 0.05 | \$ (0.27) |
| | ===== | ===== |
| Cash dividends declared per share | \$ -- | \$ 0.03375 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Edgar Filing: TECHNITROL INC - Form 10-Q

Page 3 of 41

Technitrol, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Nine Months Ended September 27, 2002 and September 28, 2001

(Unaudited)

In thousands

| | Nin Sept. 27, 2002 ---- |
|--|----------------------------------|
| Cash flows from operating activities: | |
| Net earnings (loss) | \$ (47,628) |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | |
| Depreciation and amortization | 15,136 |
| Tax benefits from employee stock compensation | 406 |
| Amortization of stock incentive plan expense | 788 |
| Restructuring and unusual and infrequent items, net of cash payments (excluding loss on disposal of assets and trade name write off, net of taxes) | 1,004 |
| Cumulative effect of accounting change, net of taxes | 15,738 |
| Loss on disposal of assets | 6,347 |
| Trade name write off, net of taxes | 19,260 |
| Changes in assets and liabilities, net of effect of acquisitions: | |
| Trade receivables | (307) |
| Inventories | 6,626 |
| Prepaid expenses and other current assets | 4,691 |
| Accounts payable and accrued expenses | (1,133) |
| Other, net | (10,280) |
| | ----- |
| Net cash provided by operating activities | 10,648 |
| | ----- |
| Cash flows from investing activities: | |
| Acquisitions, net of cash acquired | (6,708) |
| Capital expenditures | (3,764) |
| Proceeds from sale of property, plant and equipment | 897 |
| | ----- |
| Net cash used in investing activities | (9,575) |
| | ----- |
| Cash flows from financing activities: | |
| Dividends paid | (1,137) |
| Proceeds of long-term borrowings | -- |
| Principal payments of long-term debt | (75,088) |
| Payoff of debt assumed in acquisition | -- |
| Sale of stock through employee stock purchase plan | 1,291 |
| Proceeds from exercise of stock options | -- |
| Net proceeds from follow-on offering | 134,700 |
| | ----- |
| Net cash provided by financing activities | 59,766 |
| | ----- |
| Net effect of exchange rate changes on cash | (2,956) |

Edgar Filing: TECHNITROL INC - Form 10-Q

| | |
|--|---------|
| Net increase in cash and cash equivalents | 57,883 |
| Cash and cash equivalents at beginning of year | 142,267 |

| | |
|--|------------|
| Cash and cash equivalents at September 27, 2002 and September 28, 2001 | \$ 200,150 |
|--|------------|

See accompanying Notes to Unaudited Consolidated Financial Statements.

Page 4 of 41

Technitrol, Inc. and Subsidiaries
 Consolidated Statement of Changes in Shareholders' Equity
 Nine Months Ended September 27, 2002

(Unaudited)
 In thousands

| | Common stock and paid-in capital | | Retained earnings | Other Deferred compen- sation |
|--|-------------------------------------|-----------|----------------------|--|
| | Shares | Amount | ----- | ----- |
| Balance at December 28, 2001 | 33,683 | \$ 70,184 | \$ 264,055 | \$ (2,430) |
| Stock options, awards and related compensation | 24 | 378 | -- | 869 |
| Tax benefit of stock compensation | -- | 406 | -- | -- |
| Stock issued under employee stock purchase plan | 71 | 1,316 | -- | -- |
| Follow-on offering | 6,348 | 134,700 | -- | -- |
| Currency translation adjustments | -- | -- | -- | -- |
| Net loss | -- | -- | (47,628) | -- |
| Comprehensive loss | -- | -- | -- | -- |
| Balance at September 27, 2002 | 40,126 | \$206,984 | \$ 216,427 | \$ (1,561) |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Page 5 of 41

Technitrol, Inc. and Subsidiaries
 Notes to Unaudited Consolidated Financial Statements

Edgar Filing: TECHNITROL INC - Form 10-Q

(1) Accounting Policies

For a complete description of the accounting policies of Technitrol, Inc. and its consolidated subsidiaries ("the Company"), refer to Note 1 of Notes to Consolidated Financial Statements included in the Company's Form 10-K filed for the year ended December 28, 2001.

The results for the quarters ended September 27, 2002 and September 28, 2001, have been prepared by Technitrol's management without audit by its independent auditors. In the opinion of management, the financial statements fairly present, in all material respects, the financial position and results of Technitrol's operations for the periods presented. To the best knowledge and belief of Technitrol, all adjustments have been made to properly reflect income and expenses attributable to the periods presented. All such adjustments are of a normal recurring nature, except for a trade name writedown and goodwill impairment as described elsewhere in this report. Operating results for the nine months ended September 27, 2002 are not necessarily indicative of annual results.

Certain amounts in the prior year financial statements have been reclassified to conform with the current year presentation. Also refer to Note 10 "Equity Method Investment in FRE."

(2) Acquisitions

Excelsus Technologies, Inc.: In August 2001, the Company acquired all of the capital stock of Excelsus Technologies, Inc. ("Excelsus") based in Carlsbad, California. Excelsus produced customer-premises digital subscriber line filters and other broadband accessories. The acquisition was accounted for by the purchase method of accounting. The preliminary purchase price was approximately \$85.9 million, net of \$4.8 million of cash acquired and a preliminary purchase price adjustment of \$2.6 million. The fair value of net assets acquired approximated \$18.2 million. Based on the fair value of the assets acquired, the preliminary allocation of the unadjusted purchase price included \$40.0 million for trade names, \$27.0 million for goodwill and \$8.0 million for technology. The technology intangible is subject to amortization and is estimated to have a 5-year life. Included in the assets acquired was a \$6.3 million tax receivable, generated by the acceleration and settlement of Excelsus stock options at the time of closing. The Company filed income tax returns for the period ending on the closing date, and received the full amount of the tax receivable during the fourth quarter of 2001. In order to fund the purchase price, the Company used approximately \$19.0 million of cash on-hand and borrowed approximately \$74.0 million under its existing credit facility with a syndicate of commercial banks. Prior to the acquisition, Excelsus recorded revenues of approximately \$40.0 million in 2000.

Page 6 of 41

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(2) Acquisitions, continued

During the quarter ended June 28, 2002 the Company recorded an impairment charge of \$32.1 million of the value assigned to the Excelsus trade names before any tax benefit. The charge was included in line "restructuring and unusual and infrequent items" on the consolidated statement of earnings. This charge was triggered by the combined effect of reorganizing Pulse into product-line based organization and updated financial forecasts for DSL microfilters. In addition,

Edgar Filing: TECHNITROL INC - Form 10-Q

a purchase price allocation adjustment to record a deferred tax liability of \$16.0 million associated with the trade name was recorded and goodwill in an equal amount was recognized. As required by FASB Statement No. 109, Accounting for Income Taxes, approximately \$12.8 million of the additional deferred tax liability was recognized as a tax benefit in the consolidated statement of earnings for the three months ended June 28, 2002, concurrent with the trade name impairment.

Full Rise Electronics Co. Ltd. ("FRE"): FRE is based in the Republic of China (Taiwan) and manufactures connector products including single and multiple-port jacks and supplies such products for the Company under a cooperation agreement. In April 2001, the Company made a minority investment in the common stock of FRE which was accounted for by the cost-basis method of accounting. On July 27, 2002 the Company made an additional investment in FRE of \$6.7 million which increased the total investment to \$20.9 million. As a result of the increased ownership percentage to approximately 29%, the Company began to account for the investment under the equity method in the three months ended September 27, 2002. The Company also has an option to purchase additional shares of common stock in FRE in the future. Also refer to Note 10, "Equity Method Investment in FRE."

Grupo ECM: In March 2001, the Company acquired Electro Componentes Mexicana, S.A. de C.V. and affiliates based in Mexico City. These operations are referred to as Grupo ECM. Grupo ECM manufactured and marketed inductive components primarily for automotive applications. This business was integrated into Pulse. The purchase price was not material to the Company's consolidated financial position.

Engelhard-CLAL: In January 2001, the Company acquired the electrical contacts business of Engelhard-CLAL. These operations are located in France and the United Kingdom. Engelhard-CLAL manufactured electrical contacts, wire and strip contact materials and related products primarily for the European electrical equipment market. This business was integrated into AMI Doduco. The purchase price was not material to the Company's consolidated financial position.

(3) Restructuring and Unusual and Infrequent Items

The Company implemented numerous restructuring initiatives during 2002 and 2001 in order to reduce its cost structure and capacity in response to the continuing global recession in the electronics and electrical markets.

In the quarter ended September 27, 2002 the Company accrued \$0.9 million in total for severance and related payments. Pulse accrued \$0.6 million and AMI Doduco accrued \$0.3 million. Approximately 130 employees were terminated, of which 90 were direct personnel in Asia and 40 were indirect personnel in North America. A majority of these accruals were utilized by the end of the third quarter in 2002.

Page 7 of 41

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(3) Restructuring and Unusual and Infrequent Items, continued

In the second quarter of 2002, the Company accrued \$11.0 million in total for the shutdown of its Philippines manufacturing facility, severance and related payments, asset impairments and plant consolidations, all of which were

Edgar Filing: TECHNITROL INC - Form 10-Q

related to the Company's continuous cost reduction activities in response to the continuing global recession in the electronics and electrical markets. The \$11.0 million charge included \$3.8 million for the Philippines shutdown of which \$1.4 million represented severance and related payments and \$2.4 million was recorded for asset writedowns. Pulse accrued an additional \$1.0 million for severance and related payments for approximately 67 personnel on a worldwide basis and \$4.1 million for asset impairments primarily involved in Asian manufacturing. AMI Doduco accrued \$2.1 million of restructuring and unusual and infrequent items in the second quarter of 2002. This comprised approximately \$1.0 million for severance and related payments for approximately 45 people in Europe and \$1.1 million for asset impairments, writedowns and relocations in Europe. An additional \$32.1 million of Excelsus trade name impairment was recorded as discussed in Note 2, "Acquisitions".

In the first quarter of 2002, the Company accrued \$1.8 million for severance and related payments, related to the termination of approximately 400 manufacturing personnel and approximately 75 support personnel. An additional accrual of \$0.8 million was provided for asset disposals. Substantially all of these accruals were utilized by the end of the first quarter in 2002.

Approximately \$13.0 million of restructuring charges were accrued in the nine months ended September 28, 2001 to provide for severance and related payments for Pulse manufacturing personnel primarily in Asia, and to provide for the shutdown of a manufacturing facility in Thailand and Malaysia. The majority of this accrual was utilized by the end of the first quarter of 2002.

Restructuring charges are summarized on a year-to-date basis for 2002 as follows:

| Restructuring provision (in millions): ----- | AMI Doduco ----- | Pulse ----- |
|--|---------------------|-----------------|
| Balance accrued at December 28, 2001 | \$ 0.6 | \$ 2.4 |
| Accrued during the nine months ended September 27, 2002 | 2.8 | 11.7 |
| Severance and other cash payments | (1.9) | (4.8) |
| Non-cash asset disposals | -- | (6.8) |
| | ----- | ----- |
| Balance accrued at September 27, 2002 | \$ 1.5 ===== | \$ 2.5 ===== |

Page 8 of 41

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(4) Inventories

Inventories consisted of the following (in thousands):

| | September 27, 2002 ---- | December 28, 2001 ---- |
|----------------------------|-------------------------------|------------------------------|
| Finished goods | \$17,006 | \$22,159 |
| Work in process | 12,407 | 11,723 |
| Raw materials and supplies | 28,721 | 28,522 |

Edgar Filing: TECHNITROL INC - Form 10-Q

| | |
|----------|----------|
| ----- | ----- |
| \$58,134 | \$62,404 |
| ===== | ===== |

(5) Derivatives and Other Financial Instruments

The Company utilizes derivative financial instruments, primarily forward exchange contracts and currency options, to manage foreign currency risks. While these hedging instruments are subject to fluctuations in value, such fluctuations are generally offset by the fluctuations in value of the underlying exposures being hedged.

At September 27, 2002, the Company had one foreign exchange contract outstanding to hedge approximately 46.0 million of euro in the aggregate. The primary purpose of the forward contract was to hedge intercompany loans. The term of the contract was less than 30 days. The Company had no other financial derivative instruments. In addition, management believes that there is no material risk of loss from changes in market rates or prices which are inherent in other financial instruments.

Page 9 of 41

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(6) Earnings (Loss) Per Share

Basic earnings (loss) per share are calculated by dividing earnings by the weighted average number of common shares outstanding (excluding restricted shares) during the period. The Company had restricted shares outstanding of approximately 274,000 and 333,000 as of September 27, 2002 and September 28, 2001, respectively. For calculating diluted earnings per share, common share equivalents and restricted stock outstanding are added to the weighted average number of common shares outstanding. Common share equivalents result from outstanding options to purchase common stock as calculated using the treasury stock method. Such common share equivalent amounts were approximately 30,000 and 10,000 as of September 27, 2002 and September 28, 2001, respectively. As the nine-month period ended September 27, 2002 resulted in a net loss, common share equivalents are anti-dilutive, and therefore excluded from the earnings (loss) per share calculation for that period. Earnings (loss) per share calculations are as follows (in thousands, except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | Sept. 27, 2002 | Sept. 28, 2001 | Sept. 27, 2002 | Sept. 28, 2001 |
| | ---- | ---- | ---- | ---- |
| Net earnings (loss) | \$ 2,123 | \$ (9,184) | \$ (47,628) | \$ (10,000) |
| Basic earnings (loss) per share: | | | | |
| Shares | 39,826 | 33,337 | 37,322 | 33,337 |
| Per share amount, before change in accounting principle | \$ 0.05 | \$ (0.27) | \$ (0.86) | \$ (0.30) |
| Change in accounting principle | -- | -- | (0.42) | -- |
| Per share amount | \$ 0.05 | \$ (0.27) | \$ (1.28) | \$ (0.30) |
| | ===== | ===== | ===== | ===== |

Edgar Filing: TECHNITROL INC - Form 10-Q

| | | | | |
|--|---------|-----------|-----------|----|
| Diluted earnings (loss) per share: | | | | |
| Shares | 40,032 | 33,655 | 37,606 | 3 |
| Per share amount, before change in accounting principle | \$ 0.05 | \$ (0.27) | \$ (0.86) | \$ |
| Change in accounting principle | -- | -- | (0.42) | |
| Per share amount | \$ 0.05 | \$ (0.27) | \$ (1.28) | \$ |

Page 10 of 41

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(7) Business Segment Information

For the quarters ended September 27, 2002 and September 28, 2001, there were immaterial amounts of intersegment revenues eliminated in consolidation. There has been no material change in segment assets from December 28, 2001 to September 27, 2002, except for the trade name write-off and goodwill impairment as described elsewhere in this report. In addition, the basis for determining segment financial information has not changed from 2001. Specific segment data are as follows:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | Sept. 27, 2002 | Sept. 28, 2001 | Sept. 27, 2002 | Sept. 28, 2001 |
| Net sales: | | | | |
| Pulse | \$ 52,041 | \$ 50,885 | \$ 151,040 | \$ 197,000 |
| AMI Doduco | 51,585 | 49,961 | 152,191 | 173,000 |
| Total | \$ 103,626 | \$ 100,846 | \$ 303,231 | \$ 370,000 |
| Earnings (loss) before income taxes: | | | | |
| Pulse | \$ 2,354 | \$ (1,616) | \$ (267) | \$ 14,000 |
| Pulse restructuring and unusual and infrequent items | (624) | (8,267) | (43,799) | (12,000) |
| AMI Doduco | 1,236 | 37 | 1,924 | 7,000 |
| AMI Doduco restructuring and unusual and infrequent items | (252) | (541) | (2,833) | (1,000) |
| Operating profit (loss) | 2,714 | (10,387) | (44,975) | 8,000 |
| Total other income (expense) | 514 | 592 | (625) | 2,000 |
| Earnings (loss) before income taxes and cumulative effect of accounting change | \$ 3,228 | \$ (9,795) | \$ (45,600) | \$ 11,000 |

(8) Adoption of SFAS 141 and SFAS 142

Edgar Filing: TECHNITROL INC - Form 10-Q

In July 2001, the FASB issued Statement No. 141, Business Combinations, ("SFAS 141") and Statement No. 142, Goodwill and Other Intangible Assets ("SFAS 142"). SFAS 141 requires that the purchase method of accounting be used for all business combinations completed after June 30, 2001. SFAS 141 also specifies that intangible assets acquired in a purchase method business combination must meet certain criteria to be recognized and reported apart from goodwill. SFAS 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead they are tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 also requires that other intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 144.

Page 11 of 41

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(8) Adoption of SFAS 142, continued

We adopted the provisions of SFAS 141 in fiscal 2001, and SFAS 142 effective January 1, 2002. Goodwill and intangible assets determined to have an indefinite useful life acquired in a purchase business combination completed after June 30, 2001 are not amortized, but will continue to be evaluated for permanent impairment. Goodwill and intangible assets acquired in business combinations completed before July 1, 2001 were amortized until December 28, 2001. Since our acquisition of Excelsus was completed on August 7, 2001, the provisions of SFAS 141 were applied. Therefore, goodwill and certain intangibles with indefinite lives resulting from the Excelsus transaction have not been subject to amortization.

In connection with the transitional goodwill impairment evaluation, SFAS 142 required us to perform an assessment of whether goodwill is impaired as of the date of adoption. We had approximately \$80.3 million of unamortized goodwill and \$48.2 million of other intangible assets as of December 28, 2001, which was subject to the transition provisions of SFAS 141 and SFAS 142. To accomplish the impairment valuation, we determined the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. As AMI Doduco's reporting unit's carrying amount exceeded its fair value, an indication existed that the reporting unit's goodwill may be impaired and we performed the second step of the transitional impairment test. In the second step, we compared the implied fair value of the AMI Doduco's goodwill, determined by allocating the reporting unit's fair value to all of its assets and liabilities in a manner similar to a purchase price allocation in accordance with SFAS 141, to its carrying amount. As a result of the transitional impairment test, we recorded an impairment loss of \$15.7 million in the first quarter of 2002. This loss was recognized as a cumulative effect of an accounting change during the three months ended March 29, 2002.

Goodwill was not amortized for the nine months ended September 27, 2002, whereas amortization expense was \$3.4 million for the nine months ended September 28, 2001.

Page 12 of 41

Technitrol, Inc. and Subsidiaries

Edgar Filing: TECHNITROL INC - Form 10-Q

Notes to Unaudited Consolidated Financial Statements, continued

(8) Adoption of SFAS 142, continued

The following table presents the impact of SFAS 142 on net income and net income per share had the standard been in effect for the three months and nine months ended September 27, 2002 and September 28, 2001, respectively (in thousands, except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|---------------------------|---------------------------|---------------------------|
| | Sept. 27, 2002 ---- | Sept. 28, 2001 ---- | Sept. 27, 2002 ---- | Sept. 28, 2001 ---- |
| Net income (loss) - as reported | \$ 2,123 | \$ (9,184) | \$ (47,628) | \$ 7,457 |
| Adjustments: | | | | |
| Amortization of goodwill | -- | 1,163 | -- | 3,406 |
| Cumulative effect of accounting change | -- | -- | 15,763 | -- |
| Income tax effect | -- | (24) | (25) | (74) |
| | ----- | ----- | ----- | ----- |
| Net adjustments | -- | 1,139 | 15,738 | 3,332 |
| | ----- | ----- | ----- | ----- |
| Net income (loss) - adjusted | \$ 2,123 | \$ (8,045) | \$ (31,890) | \$ 10,789 |
| | ===== | ===== | ===== | ===== |
| Basic net income (loss) per share - as reported | \$ 0.05 | \$ (0.27) | \$ (1.28) | \$ 0.23 |
| Basic net income (loss) per share - adjusted | \$ 0.05 | \$ (0.24) | \$ (0.86) | \$ 0.33 |
| Diluted net income (loss) per share - as reported | \$ 0.05 | \$ (0.27) | \$ (1.28) | \$ 0.23 |
| Diluted net income (loss) per share - adjusted | \$ 0.05 | \$ (0.24) | \$ (0.86) | \$ 0.32 |

(9) Follow-on Equity Offering

The Company completed a follow-on offering of 6,348,000 shares of its common stock on April 11, 2002. The proceeds of the offering, net of expenses, were approximately \$134.7 million. The Company used approximately \$36.5 million of net proceeds from the sale of shares for voluntary repayment of outstanding debt and expects to use the remaining proceeds at approximately \$98.2 million for potential strategic acquisitions and general corporate purposes.

Page 13 of 41

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(10) Equity Method Investment in FRE

Edgar Filing: TECHNITROL INC - Form 10-Q

During the quarter ended September 27, 2002 the Company's ownership in a minority owned investment increased from approximately 19% to 29%. In accordance with generally accepted accounting principles, the Company has adjusted the prior period to reflect the impact of a change in accounting for the Company's ownership in this investment from the cost basis method to the equity method of accounting. The adjustment in 2001 reflects the Company's cumulative earnings as if the 19% investment was accounted for as an equity method investment for all periods presented. The Company's cumulative earnings recognized as of September 28, 2001 were \$0.2 million, and an additional \$0.2 million and \$0.4 million of equity earnings were recorded in the three months and nine months ended September 27, 2002, respectively. All prior period amounts have been adjusted to reflect this recognition of equity earnings as if it occurred at the time of the original investment in April 2001. The investment is reflected in the other assets caption of the Consolidated Balance Sheets.

(11) Application of Statement No. 123, Accounting for Stock Based Compensation ("SFAS 123").

On October 21, 2002 the Company announced its plan to recognize compensation expense for all stock option awards granted beginning in the 2003 fiscal year, according to FASB Statement No. 123, Accounting for Stock Based Compensation (SFAS 123). The Company intends to implement SFAS 123 under the existing transition rules, whereby compensation expense will be recorded under SFAS 123 for all awards subsequent to adoption. On a proforma basis, if the Company applied SFAS 123 for all stock option awards granted thus far in the fiscal year ending December 27, 2002, it would expect to recognize additional after-tax compensation expense of approximately \$.01 per share for the full year.

At September 27, 2002 the Company has approximately 382,000 options outstanding, representing less than 1% of the Company's outstanding shares of common stock. The value of restricted stock has always been and continues to be recorded as compensation expense over the restricted period, and such expense is included in the results of operations for the period ended September 27, 2002 and all prior periods.

Page 14 of 41

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

This discussion and analysis of our financial condition and results of operations as well as other sections of this report, contain certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could and probably will differ materially from those anticipated in these forward-looking statements for many reasons, including the risks we face described in "Risk Factors" section of this report on page 29 through 36.

Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements in the Annual Report on Form 10-K for the fiscal year ended December 28, 2001 describes the significant accounting policies and methods used in the preparation of the Consolidated Financial

Edgar Filing: TECHNITROL INC - Form 10-Q

Statements. Estimates are used for, but not limited to, the accounting for inventory allowances, goodwill impairments, restructuring expense and acquisition related restructuring costs, income taxes, and contingency reserves. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the Consolidated Financial Statements.

Inventory Allowances. Inventory purchases and commitments are based upon future demand forecasts estimated by taking into account actual purchases of our products over the recent past. If there is a sudden and significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology or customer requirements, we may be required to increase inventory allowances and our gross margin could be negatively affected. If we were to sell or use a significant portion of inventory already reserved, our gross margin could be positively affected.

Goodwill Impairment. We will assess goodwill impairment on an annual basis and between annual tests in certain circumstances. In addition, in response to changes in industry and market conditions, we may strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of goodwill.

Restructuring Expense and Acquisition Related Restructuring Costs. Our recent restructuring activities, which related to our existing and recently acquired businesses, were designed to reduce both our fixed and variable costs, particularly in response to the dramatically reduced demand for our products in the electronics components industry. These costs included the closing of facilities and the termination of employees. Acquisition-related costs are included in the allocation of the cost of the acquired business and are added to goodwill. Other restructuring costs are expensed during the period in which we determine that we will incur those costs, and all of the requirements for accrual are met.

Page 15 of 41

These restructuring costs are recorded based upon our best estimates at the time. Our actual expenditures for the restructuring activities may differ from the initially recorded costs. If this occurs, we would adjust our estimates in future periods. In the case of acquisition-related restructuring costs, and depending on whether the assets impacted came from the acquired entity and the timing of the restructuring charge, this would generally require a change in value of the goodwill appearing on our balance sheet, which may not affect our earnings. In the case of other restructuring costs, we could be required either to record additional expenses in future periods if our initial estimates were too low, or reverse part of the charges that we recorded initially if our initial estimates were too high.

Income Taxes. We have not provided for U.S. federal income and foreign withholding taxes on non-U.S. subsidiaries' undistributed earnings as calculated for income tax purposes, because, in accordance with the provisions of Accounting Principles Board Opinion No. 23, Accounting for Income Taxes - Special Areas ("APB 23") we intend to reinvest these earnings outside the U.S. indefinitely. If we encounter a significant domestic need for liquidity that we cannot fulfill through borrowings or other internal or external sources, we may experience unfavorable tax consequences as cash invested outside the U.S. is transferred to the U.S. This adverse consequence would occur if the transfer of cash into the U.S. were subject to income tax without sufficient foreign tax credits available to offset the U.S. tax liability.

Contingency Reserves. During the normal course of business, a variety of

Edgar Filing: TECHNITROL INC - Form 10-Q

issues may arise, which may result in litigation, environmental compliance and other contingent obligations. In developing our contingency reserves we consider both the likelihood of a loss or incurrence of a liability as well as our ability to reasonably estimate the amount of accrual. We accrue for contingency reserves when a liability is probable and the amount can be reasonably estimated. We periodically evaluate available information to assess whether contingency reserves should be adjusted.

Overview

We are a global producer of precision-engineered passive magnetics-based electronic components and electrical contact products and materials. We believe we are a leading global producer of these products and materials in the primary markets we serve based on our estimates of the size of our primary markets in annual revenues and our share of those markets relative to our competitors.

We operate our business in two distinct segments:

- o the electronic components segment, which operates under the name Pulse, and
- o the electrical contact products segment, which operates under the name AMI Doduco.

General. We experienced consistent growth in net sales from fiscal 1991 through fiscal 2000. We define net sales as gross sales less returns and allowances. We sometimes refer to net sales as revenue. From 1994 through 2000, the growth in our consolidated net sales was due in large part to the growth of Pulse. However, since late 2000, the electronics markets served by Pulse have experienced a severe global contraction. While there remains substantial uncertainty with respect to future demand for our products, particularly at Pulse, we believe that our markets have begun to stabilize in 2002 and that a market recovery will be slow and uneven.

Page 16 of 41

Throughout the year ended December 28, 2001 demand slowed at AMI Doduco, mirroring the prevailing economic conditions in North America and Europe. These anemic market conditions continued into 2002; however, AMI Doduco has seen increases in design and quoting activities for component subassemblies in Europe, for automotive applications such as sensor housings, multi-function switches, motor control sensors and ignition security systems, and non-automotive uses such as appliance and industrial controls and medical equipment. Although some of our customers and the popular press generally report modest economic growth for the remainder of the year, AMI Doduco continues its cost reduction actions. For example, in addition to workforce adjustments in line with market demand around the world, AMI Doduco is also continuing certain product and plant consolidation actions, particularly in Europe.

Historically, the gross margin at Pulse has been significantly higher than at AMI Doduco. As a result, the mix of net sales generated by Pulse and AMI Doduco during a period affects our consolidated gross margin. Our gross margin is also significantly affected by capacity utilization at both Pulse and AMI Doduco. Pulse's markets have experienced significant price deflation in 2002, brought about by global excess capacity and migration of significant manufacturing capacity to the Far East. However, Pulse products have a relatively short-term product life cycle. Significant product turnover occurs each year, resulting in a changing product sales mix. Therefore, Pulse's changes in revenues do not necessarily provide a meaningful and quantifiable measure of Pulse's operations. AMI Doduco has a fairly long-term and mature product line,

Edgar Filing: TECHNITROL INC - Form 10-Q

without significant turnover. While there has been variation over time in the prices of products sold, changes in unit volume account for most of the sales growth or contraction at AMI Doduco.

Acquisitions. Historically, acquisitions have been an important part of our growth strategy. In many cases, our move into new and high-growth extensions of our existing product lines or markets has been facilitated by an acquisition. Our acquisitions continually change the mix of our net sales. We have maintained ongoing acquisition activities for many years in both of our business segments. We are continuously engaged in discussions with a variety of acquisition candidates and potential strategic partners. Pulse made numerous acquisitions in recent years which have increased its penetration into its primary markets and expanded its presence in new markets. Excelsus is a recent example of these acquisitions. Excelsus was acquired in August 2001 for approximately \$85.9 million, net of cash acquired. Excelsus is based in Carlsbad, California and is a leading producer of customer-premises digital subscriber line filters and other broadband accessories.

Similarly, AMI Doduco has grown through acquisitions. Most recently, in January 2001, AMI Doduco acquired the electrical contact and materials business of Engelhard-CLAL, a manufacturer of electrical contacts, wire and strip contact materials and related products. AMI Doduco acquisitions are typically driven by its strategy of expanding its product and geographic market presence for electrical contact products.

Due to our quick integration of acquisitions and the interchangeable sources of net sales between existing and acquired operations, we cannot separately track the net sales of an acquisition, in any meaningful way, after the date of the transaction.

Page 17 of 41

Recent Cost Reduction Programs. During 1999 and 2000, the electronic components industries served by Pulse were characterized by unprecedented growth. Beginning in late 2000 and continuing all during 2001, however, the opposite trend was experienced as these industries experienced a severe worldwide contraction and virtually all of our customers canceled orders and decreased their level of business activity as a result of lower demand for their end products. While the electrical contact industry served by AMI Doduco is generally less dependent on volatile technology markets, it too was negatively impacted by general economic trends as reflected in slower overall construction spending, and reduced capital spending. Our manufacturing business model at Pulse has a very high variable cost component due to the labor-intensity of many processes. This allows us to quickly change our capacity based on market demand. Just as we expanded capacity during 1999 and 2000, we reduced capacity during 2001 and in the first half of 2002. AMI Doduco has a higher fixed cost component of manufacturing activity than Pulse, as it is more capital intensive. Therefore, AMI Doduco is unable to contract its capacity as quickly as Pulse in response to market demand, although significant actions have been taken to align AMI Doduco's capacity with market demand. In response to the decline in demand for our products, we implemented a succession of cost reduction initiatives and programs, summarized as follows:

In the third quarter of 2002, the Company accrued for \$0.9 million in total for severance and related payments. Pulse accrued \$0.6 million and AMI Doduco accrued \$0.3 million. Approximately 130 employees were terminated, of which 90 were direct personnel in Asia and 40 were indirect personnel in North America. A majority of these accruals were utilized by the end of the third quarter in 2002.

Edgar Filing: TECHNITROL INC - Form 10-Q

In the second quarter of 2002, we accrued \$11.0 million in total for the shutdown of the Philippines manufacturing facility, severance and related payments, asset impairments and plant consolidations. The \$11.0 million charge included \$3.8 million for the Philippines shutdown of which \$1.4 million represented severance and related payments and \$2.4 million was recorded for asset writedowns. Pulse accrued an additional \$1.0 million for severance and related payments for approximately 67 personnel on a worldwide basis and \$4.1 million for asset impairments primarily involved in Asian manufacturing. AMI Doduco accrued \$2.1 million of restructuring and unusual and infrequent items in the second quarter of 2002. This comprised approximately \$1.0 million for severance and related payments for approximately 45 people worldwide and \$1.1 million for asset impairments, writedowns and relocations in Europe. An additional \$32.1 million of Excelsus trade name impairment was recorded as discussed in Note 2, "Acquisitions".

In the first quarter of 2002, we accrued \$1.8 million for severance and related payments, related to the termination of approximately 400 manufacturing personnel and approximately 75 support personnel. An additional accrual of \$0.8 million was provided for asset disposals. The majority of these accruals were utilized by the end of the first quarter of 2002.

Approximately \$13.0 million of restructuring charges were accrued in the nine months ended September 28, 2001 to provide for severance and related payments for Pulse manufacturing personnel primarily in Asia, and to provide for the shutdown of manufacturing facilities in Thailand and Malaysia. The majority of these accruals were utilized by the end of the first quarter of 2002.

Page 18 of 41

As a result of our continuing focus on both economic and operating profit, we will continue to aggressively size both Pulse and AMI Doduco so that costs are minimized while we wait for the recovery in demand and pursue additional growth opportunities. The amounts of additional charges will depend on specific actions taken. The actions taken over the past two years such as plant closures, asset impairments and reduction in personnel worldwide have resulted in the elimination of a variety of costs. The majority of these costs represent the annual salaries and benefits of terminated employees, both those directly related to manufacturing and those providing selling, general and administrative services. The eliminated costs also include depreciation savings from disposed equipment and the relocation of capacity to factories in lower cost countries, primarily the PRC. If incoming orders increase substantially, additional hiring may be necessary to expand capacity. However, we do not anticipate requiring additional capacity in the foreseeable future.

Our restructuring charges are summarized for 2002 as follows:

| | AMI | | |
|--|--------|--------|--------|
| Restructuring provision (in millions): | Doduco | Pulse | Total |
| ----- | ----- | ----- | ----- |
| Balance accrued at December 28, 2001 | \$ 0.6 | \$ 2.4 | \$ 3.0 |
| Accrued during the nine months ended September 27, 2002 | 2.8 | 11.7 | 14.5 |
| Severance and other cash payments | (1.9) | (4.8) | (6.7) |
| Non-cash asset disposals | -- | (6.8) | (6.8) |
| | ----- | ----- | ----- |
| Balance accrued at September 27, 2002 | \$ 1.5 | \$ 2.5 | \$ 4.0 |
| | ===== | ===== | ===== |

Edgar Filing: TECHNITROL INC - Form 10-Q

International Operations. An increasing percentage of our sales in recent years has been outside of the United States. As of September 27, 2002, we have operations in 9 countries and we have significant net sales in currencies other than the U.S. dollar. As a result, changing exchange rates often impact our financial results and the analysis of our period-over-period results. This is particularly true of movements in the exchange rate between the U.S. dollar and the euro. AMI Doduco's European sales are denominated primarily in euros. A portion of Pulse's European sales are also denominated in euros. However, the proportion at Pulse is much less than it is at AMI Doduco. As a result of this and other factors, Pulse uses the U.S. dollar as its functional currency in Europe while AMI Doduco uses the euro. The use of different functional currencies creates varied financial effects. The euro was 3.4% stronger, on average, relative to the U.S. dollar during the nine months ended September 27, 2002 than in the comparable prior-year period. As a result, AMI Doduco's euro-denominated sales resulted in higher dollar sales upon translation for our U.S. consolidated financial statements. As the euro was 10.5% stronger than the U.S. dollar at September 27, 2002 versus December 28, 2001, we experienced a positive translation adjustment to equity in the nine months ended September 27, 2002 because our investment in AMI Doduco's European operations was worth more in U.S. dollars. If an increasing percentage of our sales is denominated in non-U.S. currencies, it could increase our exposure to currency fluctuations. The impact of exchange rate differences on AMI Doduco's European sales will be partially offset by the impact on its expenses and bank borrowings in Europe, most of which are also denominated in euros. Despite Pulse's significant presence in Asia, the vast majority of its revenues from customers in Asia are denominated in U.S. dollars. As a result, Pulse has less exposure than AMI Doduco to sales fluctuations caused by currency fluctuations.

Page 19 of 41

In order to reduce our exposure resulting from currency fluctuations, we may purchase currency exchange forward contracts and/or currency options. These contracts guarantee a predetermined range of exchange rates at the time the contract is purchased. This allows us to shift the majority of the risk of currency fluctuations from the date of the contract to a third party for a fee. As of September 27, 2002, we had one foreign exchange contract outstanding to hedge approximately 46.0 million of euro in the aggregate. The primary purpose of the forward contracts was to hedge intercompany loans. In determining the use of forward exchange contracts and currency options, we consider the amount of sales, purchases and net assets or liabilities denominated in local currencies, the type of currency, and the costs associated with the contracts.

Precious Metals. AMI Doduco uses silver, as well as other precious metals, in manufacturing many of its electrical contacts, contact materials and contact subassemblies. Historically, as is the case with most other manufacturers who use precious metals in their products, we have leased or held these materials through consignment arrangements with our suppliers. Leasing and consignment costs have been substantially below the costs to borrow funds to purchase the metals and these arrangements eliminate the fluctuations in the market price of owned precious metal. AMI Doduco's terms of sale generally allow us to charge customers for the market value of silver on the day after we deliver the silver bearing product to the customer which is also the day on which we purchase the precious metals from the lessor. Thus far we have been successful in managing the costs associated with our precious metals. While limited amounts are purchased for use in production, the majority of our precious metal inventory continues to be leased or held on consignment. If our leasing/consignment fees increase significantly in a short period of time, and we are unable to recover these increased costs through higher sale prices, a negative impact on our

Edgar Filing: TECHNITROL INC - Form 10-Q

results of operations and liquidity may result. Leasing/consignment fee increases/decreases are caused by increases/decreases in interest rates or changes in the market price of the precious metals.

Income Taxes. Our effective income tax rate is affected by the proportion of our income earned in high-tax jurisdictions such as Germany and the income earned in low-tax jurisdictions, particularly in Asia. This mix of income can vary significantly from one period to another. We have benefited over recent years from favorable offshore tax treatments. However, we may not be able to take advantage of similar benefits in the future. Developing countries and, in particular, the People's Republic of China, may change their tax policies at any time. We have not provided for U.S. federal income and foreign withholding taxes on approximately \$294.0 million of our non-U.S. subsidiaries' undistributed earnings (as calculated for income tax purposes) as of December 28, 2001. Such earnings include pre-acquisition earnings of foreign entities acquired through stock purchases, and are intended to be reinvested outside of the U.S. indefinitely. It is not practical to estimate the amount of unrecognized deferred taxes on these undistributed earnings. Where excess cash has accumulated in our non-U.S. subsidiaries and it is advantageous for tax reasons, subsidiary earnings may be remitted.

Page 20 of 41

Results of Operations

Three months ended September 27, 2002 compared to the three months ended September 28, 2001

Net Sales. Net sales for the three months ended September 27, 2002 increased \$2.8 million, or 2.8%, to \$103.6 million from \$100.8 million for the three months ended September 28, 2001. Our sales increase from the comparable period last year was attributable primarily to erratically improving end user markets for our legacy products, gains from acquisitions and a stronger euro to U.S. dollar conversion rate. Generally, end user markets remain sluggish, characterized by declining capital expenditures by end-users, excess inventory levels throughout the supply chain, lack of end user demand for both electronic and electrical products and continued price deflation.

Pulse's net sales increased \$1.2 million, or 2.3%, to \$52.0 million for the three months ended September 27, 2002 from \$50.9 million for the three months ended September 28, 2001. Net sales in 2002 include sales derived from our acquisition of Excelsus since the date of its acquisition in August 2001. Product mix shifts and price deflation contributed to downward pressure on net sales.

AMI Doduco's net sales increased \$1.6 million, or 3.3%, to \$51.6 million for the three months ended September 27, 2002 from \$50.0 million for the three months ended September 28, 2001. Sales in the 2002 period reflect a stronger average euro-to-U.S. dollar exchange rate, and continuing weakness in North American and European markets due to lower manufacturing activity in the commercial and industrial controls and non-residential construction markets.

Cost of Sales. Our cost of sales decreased \$1.0 million, or 1.2%, to \$77.7 million for the three months ended September 27, 2002 from \$78.7 million for the three months ended September 28, 2001. Our consolidated gross margin for the three months ended September 27, 2002 was 25.0% compared to 22.0% for the three months ended September 28, 2001. Our consolidated gross margin for the third quarter of 2002 was positively affected by the following factors:

- o Capacity reductions, resulting in a higher average capacity

Edgar Filing: TECHNITROL INC - Form 10-Q

utilization at both Pulse and AMI Doduco, and

- o the positive effects of our cost-down initiatives taken throughout 2001 and 2002.

Offsetting these positive factors on gross margin was a change in product mix to lower margin products and decreased average selling prices primarily at Pulse.

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the three months ended September 27, 2002 decreased \$1.4 million, or 6.0%, to \$22.3 million, or 21.5% of net sales, from \$23.7 million, or 23.5% of net sales, for the three months ended September 28, 2001. The decrease in selling, general and administrative expenses in 2002 was due to aggressive action that we took to reduce costs and tighten spending controls. During the third quarter of 2002 the positive impact of these actions was partially offset by expenses relating to compensation related accruals and other one-time accruals which are not expected to recur in the subsequent quarter. The aggregate amount of these items was approximately \$1.7 million in the quarter ended September 27, 2002.

Page 21 of 41

Research, development and engineering expenses are included in selling, general and administrative expenses. We refer to research, development and engineering expenses as RD&E. For the three months ended September 27, 2002 and September 28, 2001 respectively, RD&E by segment was as follows (dollars in thousands):

| | 2002 | 2001 |
|-----------------------------|----------|----------|
| | ---- | ---- |
| Pulse | \$ 3,286 | \$ 3,894 |
| Percentage of segment sales | 6.3% | 7.7% |
| AMI Doduco | \$ 1,038 | \$ 1,026 |
| Percentage of segment sales | 2.0% | 2.1% |

Although 2001 and 2002 have been characterized by cost reduction activities and much lower sales levels, particularly at Pulse, we minimized spending cuts in the RD&E area as we believe that the recovery in the electronic components markets will be driven by next-generation products. Design and development activities with our OEM customers continue at an aggressive pace.

Interest. Net interest income was \$0.1 million for the three months ended September 27, 2002 compared to essentially zero net interest expense for the three months ended September 28, 2001. This increase in net interest income is due primarily to a higher invested cash balance, which averaged \$199.4 million during the quarter ended September 28, 2002 and \$173.7 million during the quarter ended September 27, 2001 offset by a lower interest income rate. The increase in cash in 2002 is primarily attributable to the follow-on offering proceeds of \$134.7 million less \$36.5 million in debt payments to retire outstanding debt. Also, we reduced total debt from September 28, 2001 to September 27, 2002 by \$104.7 million, primarily due to payments made to retire outstanding debt, somewhat offset by the effect of euro denominated debt being valued at a weaker average U.S. dollar to euro rate on the September 27, 2002 consolidated balance sheet.

Our primary credit facility, which we entered into on June 20, 2001, has variable interest rates. Accordingly, interest expense may increase if the rates associated with, or the amounts borrowed under, our credit facilities move

Edgar Filing: TECHNITROL INC - Form 10-Q

higher during subsequent quarters. We did not have any borrowings outstanding under this credit facility as of September 27, 2002. If, in the future, we borrow under the facility, we may use interest rate swaps or other financial derivatives in order to manage the risk associated with changes in market interest rates; however, we have not used any such instruments to date in 2002.

Income Taxes. The effective income tax rate for the three months ended September 27, 2002, was 34.2% compared to 6.2%, in the form of a benefit, for the three months ended September 28, 2001. The higher tax rate in 2002 resulted from higher taxable income and a higher proportion of income in high tax jurisdictions in the three months ended September 27, 2002 versus the comparable period in 2001. In 2002, we also experienced a higher proportion of non-deductible restructuring and unusual and infrequent items than in 2001.

Page 22 of 41

Nine months ended September 27, 2002 compared to the nine months ended September 28, 2001

Net Sales. Net sales for the nine months ended September 27, 2002 decreased \$67.7 million, or 18.3%, to \$303.2 million from \$370.9 million for the nine months ended September 28, 2001. Our sales decline from the comparable period last year was attributable primarily to erratically improving end user markets for our legacy products. During the first three months of the 2001 period, sales remained at a relatively high level as shipments in the electronic components industry benefited from high order rates in the closing weeks of 2000. Generally, end user markets remain sluggish, characterized by declining capital expenditures by end-users, excess inventory levels throughout the supply chain, lack of end user demand for both electronic and electrical products and continued price deflation.

Pulse's net sales decreased \$46.8 million, or 23.7%, to \$151.0 million for the nine months ended September 27, 2002 from \$197.9 million for the nine months ended September 28, 2001. This decline was experienced in Pulse's networking, telecommunications and power conversion markets on a worldwide basis, particularly in North America and Europe. A significant portion of Pulse sales during the nine months ended September 28, 2001 were for products ordered in 2000, before the dramatic slowdown began. Net sales in 2002 include full nine months of sales derived from our acquisitions of Grupo ECM and Excelsus since the date of their acquisition in March 2001 and August 2001, respectively. Product mix shifts and price deflation contributed to downward pressure on net sales.

AMI Doduco's net sales decreased \$20.9 million, or 12.1%, to \$152.2 million for the nine months ended September 27, 2002 from \$173.1 million in the nine months ended September 28, 2001. Sales in the 2002 period reflect continuing weakness in North American and European markets, but a stronger average euro-to-U.S. dollar exchange rate. Lower net sales resulted from lower manufacturing activity primarily related to customers in the commercial and industrial controls and non-residential construction industries.

Cost of Sales. Our cost of sales decreased \$40.2 million, or 14.7%, to \$233.4 million for the nine months ended September 27, 2002 from \$273.6 million for the nine months ended September 28, 2001. This decrease was primarily due to a decrease in net sales. Our consolidated gross margin for the nine months ended September 27, 2002 was 23.0% compared to 26.2% for the nine months ended September 28, 2001. Our consolidated gross margin in 2002 was negatively affected by:

- o a mix of net sales weighted more toward AMI Doduco which typically

Edgar Filing: TECHNITROL INC - Form 10-Q

have a lower gross margin than those of Pulse,

- o manufacturing inefficiencies at both Pulse and AMI Doduco due to under-utilization of capacity and continued consolidation activities in European, Asian and North American manufacturing facilities, and
- o a proportionate increase in sales at Pulse of new products for which optimal manufacturing efficiency has yet to be achieved.

These factors more than offset the effect of our cost-down initiatives taken throughout 2001 and 2002.

Page 23 of 41

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the nine months ended September 27, 2002 decreased \$7.6 million, or 10.0%, to \$68.2 million, or 22.5% of net sales, from \$75.8 million, or 20.4% of net sales for the nine months ended September 28, 2001. The decrease in selling, general and administrative expenses in 2002 in dollars was due to aggressive action that we took to reduce costs and tighten spending controls and lower incentive awards and expenses related to our restricted stock plan in 2002. The underlying expense for incentive awards is primarily variable and dependent upon our overall financial performance regarding incentive plan targets, primarily the achievement of economic profit and net operating profit objectives. These incentive awards were \$0.5 million in the nine months ended September 28, 2001. Expenses associated with stock-based compensation plans including the restricted stock plan were lower in the nine months ended September 27, 2002 versus the comparable period in 2001, due to a lower number of shares awarded, and a lower average share price of our common stock in 2002 compared to 2001. These expenses were \$0.7 million in the nine months ended September 27, 2002 and \$0.9 million in the nine months ended September 28, 2001.

Research, development and engineering expenses are included in selling, general and administrative expenses. We refer to research, development and engineering expenses as RD&E. For the nine months ended September 27, 2002 and September 28, 2001 respectively, RD&E by segment was as follows (dollars in thousands):

| | 2002 ---- | 2001 ---- |
|-----------------------------|--------------|--------------|
| Pulse | \$ 10,775 | \$ 11,855 |
| Percentage of segment sales | 7.1% | 6.0% |
| AMI Doduco | \$ 2,928 | \$ 3,189 |
| Percentage of segment sales | 1.9% | 1.8% |

Although 2001 and the first nine months of 2002 have been characterized by cost reduction activities and much lower sales levels, particularly at Pulse, we minimized spending cuts in the RD&E area as we believe that the recovery in the electronic components markets will be driven by next-generation products. Design and development activities with our OEM customers continue at an aggressive pace.

Interest. Net interest expense was \$0.2 million for the nine months ended September 27, 2002 compared to net interest income of \$1.9 million for the nine months ended September 28, 2001. This decrease in net interest income is due primarily to commitment fees on our revolving credit agreement, despite a higher invested cash balance, and a lower interest income rate. Cash and cash equivalents increased from December 28, 2001 to September 27, 2002 by \$57.9 million, from \$142.3 million to \$200.2 million. The increase in cash is

Edgar Filing: TECHNITROL INC - Form 10-Q

attributable primarily to the follow-on offering proceeds of \$134.7 million less debt payments of \$75.1 million to retirement of outstanding debt. Total debt decreased from December 28, 2001 to September 27, 2002 by \$73.6 million, primarily due to \$75.1 paid to retire outstanding debt, partially offset by the effect of euro denominated debt being valued at a weaker average U.S. dollar to euro rate on the September 27, 2002 consolidated balance sheet.

Page 24 of 41

Income Taxes. The effective income tax rate, before cumulative effect of accounting change, in the form of a benefit for the nine months ended September 27, 2002, was 30.1% compared to 33.7% of income tax expense for the nine months ended September 28, 2001. The tax benefit reflects a higher proportion of deductible restructuring and infrequent items, partially offset by certain losses for which a benefit may not be realized.

Liquidity and Capital Resources

Working capital as of September 27, 2002 was \$228.8 million compared to \$189.3 million at December 28, 2001. This increase was primarily due to higher invested cash as of September 27, 2002 related to net follow-on offering proceeds partially offset by \$9.9 million reclassified from long-term debt to current installments of long-term debt as of December 28, 2001. This debt reflects fixed rate term loans due June 26, 2003. Cash and cash equivalents, which is included in working capital, increased from \$142.3 million as of December 28, 2001 to \$200.2 million as of September 27, 2002.

Net cash provided by operating activities was \$10.6 million for the nine months ended September 27, 2002 and \$62.2 million in the comparable period of 2001, a decrease of \$51.6 million. The first nine months of 2001 were categorized by a dramatic decrease in sales. The resulting decrease in accounts receivable and inventories generated significant positive cash flow in the first nine months of 2001.

During the nine months ended September 27, 2002, net earnings declined as a result of the continuing slowdown in our markets, primarily those served by Pulse. However, the lower earnings have been partially offset by decreased working capital requirements and aggressive cash management actions that we took in response to the slowdown. Inventory declined by \$6.6 million during the nine months ended September 27, 2002 due to the reduction in Pulse's net sales during the period and corresponding actions to limit purchases and production activity.

Capital expenditures were \$3.8 million during the nine months ended September 27, 2002 and \$10.5 million in the comparable period of 2001. The level of capital expenditures decreased due to tight spending controls, lower Pulse capacity needs resulting from lower sales, and our efforts to maximize cash flow during this period of slow market activity. We significantly reduced our capital spending in 2001 as compared to fiscal 2000 and expect that our spending in 2002 will be less than in 2001. We make capital expenditures to expand production capacity and to improve our operating efficiency. We plan to continue making such expenditures in the future.

There was \$6.7 million cash used for acquisitions in the nine months ended September 27, 2002, whereas during the nine months ended September 28, 2001 there was \$115.4 million used for acquisitions. The 2002 spending was for the additional equity investment in Full Rise Electronics, Co., Ltd. We exercised our option to expand our investment in FRE on July 27, 2002, with an additional investment of approximately \$6.7 million which increased our total investment to \$20.9 million. As a result of the increase in ownership percentage to approximately 29%, we recognized our investment under the equity method in the

Edgar Filing: TECHNITROL INC - Form 10-Q

three months ending September 27, 2002. Under the equity method, our proportionate share of income or loss of FRE as determined under U.S. generally accepted accounting principles will be reflected in our consolidated statement of earnings. The 2001 spending included the acquisitions of Engelhard-CLAL, Grupo ECM, Excelsus and the initial cost basis investment in FRE. We may acquire other businesses or product lines to expand our breadth and scope of operations.

Page 25 of 41

We paid dividends of \$1.1 million in the nine months ended September 27, 2002, and \$3.4 million in the comparable period of 2001. We received proceeds of \$1.3 million during the nine months ended September 27, 2002, and \$6.5 million in the comparable period of 2001 from the sale of stock through our employee stock purchase plan. After paying a dividend on January 25, 2002, to shareholders of record on January 4, 2002, we said that we no longer intend to pay cash dividends on our common stock. We currently intend to retain future earnings to finance the growth of our business.

As of September 27, 2002, we have no outstanding borrowings under our existing three-year revolving credit agreement. We entered into this credit agreement on June 20, 2001 providing for \$225.0 million of credit capacity. Following the conclusion of our follow-on equity offering, we voluntarily reduced the size of this credit facility to a maximum of \$175.0 million in order to reduce commitment fees and to size the facility to estimated future needs given cash on hand. We also amended the minimum net worth threshold from \$275.0 million to \$259.3 million as a result of goodwill impairment charge recorded in the three months ended March 29, 2002. The amended facility consists of:

- o an aggregate U.S. dollar-based revolving line of credit in the principal amount of up to \$175.0 million including individual sub-limits of:
 - o a British pounds sterling-based or euro-based revolving line of credit in the principal amount of up to the U.S. dollar equivalent of \$75.0 million; and
 - o a multicurrency facility providing for the issuance of letters of credit in an aggregate amount not to exceed the U.S. dollar equivalent of \$10.0 million.

At September 27, 2002 we had \$175.0 million of unused credit available under the amended credit agreement. The credit facility also contains covenants requiring maintenance of minimum net worth, maximum debt to EBITDA ratio, minimum interest expense coverage, capital expenditure limitations, and other customary and normal provisions. We are in compliance with all such covenants. Outstanding borrowings are limited to a maximum of three times our earnings before interest, taxes, depreciation and amortization, ("EBITDA") on a rolling twelve-month basis.

We pay a facility fee irrespective of whether there are outstanding borrowings or not, which ranges from 0.275% to 0.450% of the total commitment, depending on our EBITDA. The interest rate for each currency's borrowing will be a combination of the base rate for that currency plus a credit margin spread. The base rate is different for each currency. It is LIBOR or prime rate for U.S. dollars, Euro-LIBOR for euros, and a rate approximating sterling LIBOR for British pounds. The credit margin spread is the same for each currency and is 0.850% to 1.425% depending on our debt to EBITDA ratio. Each of our domestic subsidiaries with net worth equal to or greater than \$5 million has agreed to guarantee all obligations incurred under the credit facility.

Edgar Filing: TECHNITROL INC - Form 10-Q

We also have obligations outstanding under two term loan agreements. The first is with Baden-Württembergische Bank for borrowing under two loans, each in the amount of approximately 5.1 million euro, both due in June 2003. The second is with Sparkasse Pforzheim, for the borrowing of approximately 5.1 million euro, and is due in August 2009.

We had two stand by letters of credit outstanding at September 27, 2002 in the aggregate amount of \$2.2 million securing transactions entered into in the ordinary course of business.

Page 26 of 41

We believe that the combination of cash on hand, cash generated by operations and, if necessary, additional borrowings under our credit agreement will be sufficient to satisfy our short-term and long-term operating cash requirements. In addition, we may use internally generated funds or borrowings for acquisitions of suitable businesses or assets. On April 11, 2002 we completed a follow-on equity offering. The proceeds of the offering, net of expenses, were approximately \$134.7 million. Approximately \$36.5 million was used to retire outstanding debt. The remainder of approximately \$98.2 million is expected to be used for potential strategic acquisitions and general corporate purposes. We have maintained ongoing acquisition activities for many years in both of our business segments. We are continuously engaged in discussions with a variety of acquisition candidates and potential strategic partners.

With the exception of approximately \$10.0 million of retained earnings as of December 28, 2001 in the PRC that are restricted in accordance with Section 58 of the PRC Foreign Investment Enterprises Law, substantially all retained earnings are free from legal or contractual restrictions. The amount restricted in accordance with the PRC Foreign Investment Enterprise Law is for employee welfare programs and is applicable to all foreign investment enterprises doing business in the PRC. The restriction applies to 10% of our net retained earnings in the PRC, not to exceed 50% of the total capital invested in the PRC. We have not experienced any significant liquidity restrictions in any country in which we operate and none are foreseen. However, foreign exchange ceilings imposed by local governments and the sometimes lengthy approval processes which some foreign governments require for international cash transfers may delay our internal cash movements from time to time. The retained earnings in other countries represent a material portion of our assets. We expect to reinvest these earnings outside of the United States because we anticipate that a significant portion of our opportunities for growth in the coming years will be abroad. If these earnings were brought back to the United States, significant tax liabilities could be incurred in the United States as several countries in which we operate have rates significantly lower than the U.S. statutory rate. Additionally, we have not accrued U.S. income taxes on foreign earnings indefinitely invested abroad. We have also been granted special tax incentives in other countries such as the PRC. This favorable situation could change if these countries were to increase rates or revoke the special tax incentives, or if we were to discontinue manufacturing operations in these countries. This could have a material unfavorable impact on our net income and cash position.

In order to reduce interest expense, we commenced an intercompany lending program during the year ended December 28, 2001, whereby excess U.S. dollar denominated cash is being used to retire euro denominated debt. There are several benefits derived from this program, including lower net interest expense, as the U.S. dollar interest income rates have been decreasing, while the euro interest expense rates have declined less rapidly. In addition, we avoid paying a credit facility spread.

New Accounting Pronouncements

In July 2002, the Financial Accounting Standards Board ("FASB") issued Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities, ("SFAS 146"). SFAS 146 nullifies EITF Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity including Certain Costs Incurred in a Restructuring, ("EITF 94-3"). The principal difference between SFAS 146 and EITF 94-3 relates to the recognition of a liability for a cost associated with an exit or disposal activity. SFAS 146 requires that a liability be recognized for those costs only when the liability is incurred, that is, when it meets the definition of a liability in the FASB's conceptual framework. In contrast, EITF 94-3 required recognition of a liability for an exit cost when management committed to an exit plan. SFAS 146 also establishes fair value as the objective for initial measurement of liabilities related to exit or disposal activities. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The provisions of EITF 94-3 apply until adoption of SFAS 146. We plan to continue applying the provisions of EITF 94-3 for the remainder of our fiscal year 2002. The impact on our operating results upon adoption of this standard cannot be determined at this time and depends on our future restructuring actions.

In October 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, ("SFAS 144") which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While SFAS 144 supersedes FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, ("SFAS 121") it retains many of the fundamental provisions of SFAS 121. SFAS 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, ("APB 30"). SFAS 144 does however, retain the requirement in APB 30 to report separately discontinued operations, and extends this reporting requirement to a component of an entity that either has been disposed of by sale, abandonment, or in a distribution to owners; or is classified as held for sale. Goodwill is excluded from the scope of SFAS 144. We were required to adopt the provisions of SFAS 144 during the three months ended March 29, 2002. Adoption of this standard did not have a material effect on our net sales, operating results or liquidity.

In August 2001, the FASB issued Statement No. 143, Accounting for Asset Retirement Obligations ("SFAS 143") which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS 143 applies to legal obligations associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and (or) normal use of the assets. SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value of the liability is added to the carrying amount of the associated asset and this additional carrying amount is depreciated over the life of the asset. The liability is accreted at the end of each period through charges to operating expense. If the obligation is settled for other than the carrying amount of the liability, a gain or loss on settlement will be recognized. We are required to adopt the provisions of SFAS 143 during the three months ending March 28, 2003. Adoption of this standard is not expected to have a material effect on our net sales, operating results or liquidity.

Edgar Filing: TECHNITROL INC - Form 10-Q

Factors That May Affect Our Future Results (Cautionary Statements for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995)

Our disclosures and analysis in this report contain forward-looking statements. Forward-looking statements reflect our current expectations of future events or future financial performance. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They often use words such as "anticipate", "estimate", "expect", "project", "intend", "plan", "believe", and similar terms. These forward-looking statements are based on our current plans and expectations.

Any or all of our forward-looking statements in this report may prove to be incorrect. They may be affected by inaccurate assumptions we might make or by risks and uncertainties which are either unknown or not fully known or understood. Accordingly, actual outcomes and results may differ materially from what is expressed or forecasted in this report.

We sometimes provide forecasts of future financial performance. The risks and uncertainties described under "Risk Factors" as well as other risks identified from time to time in other Securities and Exchange Commission reports, registration statements and public announcements, among others, should be considered in evaluating our prospects for the future. We undertake no obligation to release updates or revisions to any forward-looking statement, whether as a result of new information, future events or otherwise.

Risk Factors

Cyclical changes in the markets we serve, including the recent contraction, could result in a significant decrease in demand for our products and reduce our profitability.

Our components are used in various products for the electronic and electrical equipment markets. These markets are highly cyclical. The demand for our components reflects the demand for products in the electronic and electrical equipment markets generally. Beginning in late 2000 and continuing into 2002, these markets, particularly the electronics market, have experienced a severe worldwide contraction. This contraction has resulted in a decrease in demand for our products, as our customers have:

- o canceled many existing orders;
- o introduced fewer new products; and
- o worked to decrease their inventory levels.

The decrease in demand for our products has had a significant adverse effect on our operating results and profitability. We cannot predict how long a contraction will last or the strength of any recovery. Accordingly, we may continue to experience weakness in both our revenues and profits.

Reduced prices for our products may adversely affect our profit margins if we are unable to reduce our costs of production.

The average selling prices for our products tend to decrease over their life cycle. In addition, the recent economic contraction has significantly increased the pressure on our customers to seek lower prices from their suppliers. As a result, our customers have continued to demand lower prices from us. To maintain our margins and remain profitable, we must continue to meet our customers' design needs while reducing costs through efficient raw material

Edgar Filing: TECHNITROL INC - Form 10-Q

procurement and process and product improvements. Our profit

Page 29 of 41

margins will suffer if we are unable to reduce our costs of production as sales prices decline.

An inability to adequately respond to changes in technology may decrease our sales.

Pulse operates in an industry characterized by rapid change caused by the frequent emergence of new technologies. Generally, we expect life cycles for our products in the electronic components industry to be relatively short. This requires us to anticipate and respond rapidly to changes in industry standards and customer needs and to develop and introduce new and enhanced products on a timely and cost effective basis. Our engineering and development teams place a priority on working closely with our customers to design innovative products and improve our manufacturing processes. Our inability to react to changes in technology quickly and efficiently may decrease our sales and profitability.

If our inventories become obsolete, our future performance and operating results will be adversely affected.

The life cycles of our products depend heavily upon the life cycles of the end products into which our products are designed. Many of Pulse's products have very short life cycles which are measured in quarters. Products with short life cycles require us to closely manage our production and inventory levels. Inventory may become obsolete because of reductions in end market demand. During market slowdowns, this may result in significant charges for inventory write offs, as was the case during 2001. Our future operating results may be adversely affected by material levels of obsolete or excess inventories.

An inability to capitalize on our recent or future acquisitions may adversely affect our business.

In recent years we have completed several acquisitions. We continually seek acquisitions to grow our business. We may fail to derive significant benefits from our acquisitions. In addition, if we fail to achieve sufficient financial performance from an acquisition, goodwill and other intangibles could become impaired, resulting in our recognition of a loss. While our acquisitions have not generally resulted in goodwill impairment in the past, upon the adoption of SFAS 142, we recorded a goodwill impairment charge in the first quarter of 2002 of approximately \$15.7 million related to AMI Doduco. The degree of success of any of our acquisitions depends on our ability to:

- o successfully integrate or consolidate acquired operations into our existing businesses;
- o identify and take advantage of cost reduction opportunities; and
- o further penetrate the markets for the product capabilities acquired.

Integration of acquisitions may take longer than we expect and may never be achieved to the extent originally anticipated. This could result in slower than anticipated business growth or higher than anticipated costs. In addition, acquisitions may:

- o cause a disruption in our ongoing business;
- o distract our managers;

- o unduly burden our other resources; and
- o result in an inability to maintain our historical standards, procedures and controls.

Page 30 of 41

Integration of acquisitions into the acquiring segment may limit the ability of investors to track the performance of individual acquisitions and to analyze trends in our operating results.

Our practice has been to quickly integrate acquisitions into the existing business of the acquiring segment and to only report financial performance on the segment level. As a result of this practice, we do not separately track the stand-alone performance of acquisitions after the date of the transaction. Consequently, investors cannot quantify the financial performance and success of any individual acquisition or the financial performance and success of a particular segment excluding the impact of acquisitions. In addition, our practice of quickly integrating acquisitions into the financial performance of each segment may limit the ability of investors to analyze any trends in our operating results over time.

An inability to identify additional acquisition opportunities may slow our future growth.

We intend to continue to identify and consummate additional acquisitions to further diversify our business and to penetrate important markets. We may not be able to identify suitable acquisition candidates at reasonable prices. Even if we identify promising acquisition candidates, the timing, price, structure and success of future acquisitions are uncertain. An inability to consummate attractive acquisitions may reduce our growth rate and our ability to penetrate new markets.

If our customers terminate their existing agreements, or do not enter into new agreements or submit additional purchase orders for our products, our business will suffer.

Most of our sales are made on a purchase order basis as needed by our customers. In addition, to the extent we have agreements in place with our customers, most of these agreements are either short term in nature or provide our customers with the ability to terminate the arrangement with little or no prior notice. Our contracts typically do not provide us with any material recourse in the event of non-renewal or early termination. We will lose business and our revenues will decrease if a significant number of customers:

- o do not submit additional purchase orders;
- o do not enter into new agreements with us; or
- o elect to terminate their relationship with us.

If we do not effectively manage our business in the face of fluctuations in the size of our organization, our business may be disrupted.

We have grown rapidly over the last five years, both organically and as a result of acquisitions. However, in the past eighteen months we have significantly reduced our workforce and facilities in response to a dramatic decrease in demand for our products due to prevailing global market conditions. These rapid fluctuations place strains on our resources and systems. If we do

Edgar Filing: TECHNITROL INC - Form 10-Q

not effectively manage our resources and systems, our business may suffer.

Uncertainty in demand for our products may result in increased costs of production and an inability to service our customers.

We currently have very little visibility into our customers' future purchasing intentions and are highly dependent on our customers' forecasts. These forecasts are non-binding and often highly unreliable. Given the fluctuation in growth rates and cyclical demand for our products, as well as our reliance on often imprecise customer forecasts, it is difficult to accurately manage our production schedule, equipment and personnel needs and

Page 31 of 41

our raw material and working capital requirements. Our failure to effectively manage these issues may result in:

- o production delays;
- o increased costs of production;
- o an inability to make timely deliveries; and
- o a decrease in profits.

A decrease in availability or increase in cost of our key raw materials could adversely affect our profit margins.

We use several types of raw materials in the manufacturing of our products, including:

- o precious metals such as silver;
- o base metals such as copper and brass; and
- o ferrite cores.

Some of these materials are produced by a limited number of suppliers. From time to time, we may be unable to obtain these raw materials in sufficient quantities or in a timely manner to meet the demand for our products. The lack of availability or a delay in obtaining any of the raw materials used in our products could adversely affect our manufacturing costs and profit margins. In addition, if the price of our raw materials increases significantly over a short period of time, customers may be unwilling to bear the increased price for our products and we may be forced to sell our products containing these materials at prices that reduce our profit margins.

Some of our raw materials, such as precious metals, are considered commodities and are subject to price volatility. We attempt to limit our exposure to fluctuations in the cost of precious materials, including silver, by holding the majority of our precious metal inventory through leasing or consignment arrangements with our suppliers. We then typically purchase the precious metal from our supplier at the current market price on the day after delivery to our customer and pass this cost on to our customer. In addition, leasing and consignment costs have historically been substantially below the costs to borrow funds to purchase the precious metals. We currently have four consignment or leasing agreements related to precious metals, all of which generally have one year terms with varying maturity dates, but can be terminated by either party with 30 days' prior notice. Our results of operations and liquidity will be negatively impacted if:

Edgar Filing: TECHNITROL INC - Form 10-Q

- o we are unable to enter into new leasing or consignment arrangements with similarly favorable terms after our existing agreements terminate, or
- o our leasing or consignment fees increase significantly in a short period of time and we are unable to recover these increased costs through higher sale prices.

Fees charged by the consignor are driven by interest rates and the market price of the consigned material. The market price of the consigned material is determined by the supply of and the demand for the material. Consignment fees will increase if interest rates or the price of the consigned material increase.

Page 32 of 41

Competition may result in lower prices for our products and reduced sales.

Both Pulse and AMI Doduco frequently encounter strong competition within individual product lines from various competitors throughout the world. We compete principally on the basis of:

- o product quality and reliability;
- o global design and manufacturing capabilities;
- o breadth of product line;
- o customer service; and
- o price.

Our inability to successfully compete on any or all of the above factors may result in reduced sales.

Our backlog is not an accurate measure of future revenues and is subject to customer cancellation.

While our backlog consists of firm accepted orders with an express release date generally scheduled within six months of the order, many of the orders that comprise our backlog may be canceled by customers without penalty. It is widely known that customers in the electronics industry have on occasion double and triple ordered components from multiple sources to ensure timely delivery when quoted lead time is particularly long. In addition, customers often cancel orders when business is weak and inventories are excessive, a process that we have experienced in the current contraction. In addition, when there is significant over capacity in the electronics business as now exists, customer lead times become very short (a matter of several weeks), thus reducing backlog. Lastly, customers are requiring more and more consignment and vendor managed inventory type arrangements which also serve to reduce backlog. Although you should not rely on our backlog as an indicator of our future revenues, our results of operations could be adversely impacted if customers cancel a material portion of orders in our backlog.

Fluctuations in foreign currency exchange rates may adversely affect our operating results.

We manufacture and sell our products in various regions of the world and export and import these products to and from a large number of countries. Fluctuations in exchange rates could negatively impact our cost of production

Edgar Filing: TECHNITROL INC - Form 10-Q

and sales that, in turn, could decrease our operating results and cash flow. For example, there has been a material devaluation of the euro against the U.S. dollar in the last several years which has negatively impacted our reported profits. In recent months, the euro has strengthened substantially against the U.S. dollar. Although we engage in limited hedging transactions, including foreign currency contracts, to reduce our transaction and economic exposure to foreign currency fluctuations, these measures may not eliminate or substantially reduce our risk in the future.

Page 33 of 41

Our international operations subject us to the risks of unfavorable political, regulatory, labor and tax conditions in other countries.

We manufacture and assemble some of our products in foreign locations, including Estonia, France, Germany, Hungary, Italy, Mexico, the Peoples' Republic of China, or PRC, and Spain. Our future operations and earnings may be adversely affected by the risks related to, or any other problems arising from, operating in international markets.

Risks inherent in doing business internationally may include:

- o economic and political instability;
- o expropriation and nationalization;
- o trade restrictions;
- o capital and exchange control programs;
- o transportation delays;
- o foreign currency fluctuations; and
- o unexpected changes in the laws and policies of the United States or of the countries in which we manufacture and sell our products.

In particular, Pulse has a significant portion of its manufacturing operations in the PRC. Our presence in the PRC has enabled Pulse to maintain lower manufacturing costs and to flexibly adjust its work force to demand levels for its products. Although the PRC has a large and growing economy, its potential economic, political, legal and labor developments entail uncertainties and risks. While the PRC has been receptive to foreign investment, we cannot be certain that its current policies will continue indefinitely into the future. In the event of any changes that adversely affect our ability to conduct our operations within the PRC, our business will suffer.

In addition, we have benefited over recent years from favorable tax treatment as a result of our international operations. We operate in foreign countries where we realize favorable income tax treatment relative to the U.S. statutory rate. We have also been granted special tax incentives commonly known as tax holidays in other countries such as the PRC. This favorable situation could change if these countries were to increase rates or revoke the special tax incentives, or if we discontinue our manufacturing operations in any of these countries and do not replace the operations with operations in other locations with favorable tax incentives. Accordingly, in the event of changes in laws and regulations affecting our international operations, we may not be able to continue to take advantage of similar benefits in the future.

Shifting our operations between regions may entail considerable expense.

Edgar Filing: TECHNITROL INC - Form 10-Q

In the past we have shifted our operations from one region to another in order to maximize manufacturing and operational efficiency. We may close one or more additional factories in the future. This could entail significant one-time earnings charges to account for severance, equipment write offs or writedowns and moving expenses. In addition, as we implement transfers of our operations we may experience disruptions, including strikes or other types of labor unrest resulting from lay offs or termination of employees.

Page 34 of 41

Liquidity requirements could necessitate movements of existing cash balances which may be subject to restrictions or cause unfavorable tax and earnings consequences.

A significant portion of our cash is held offshore by our international subsidiaries and is predominantly denominated in U.S. dollars. If we encounter a significant domestic need for liquidity that we cannot fulfill through borrowings or other internal or external sources, we may experience unfavorable tax and earnings consequences as this cash is transferred to the United States. These adverse consequences would occur if the transfer of cash into the United States were subject to income tax without sufficient foreign tax credits available to offset the U.S. tax liability. In addition, we may be prohibited from transferring cash from the PRC. With the exception of approximately \$10.0 million of retained earnings as of December 28, 2001 in the PRC that are restricted in accordance with the PRC Foreign Investment Enterprises Law, substantially all retained earnings are free from legal or contractual restrictions. The PRC Foreign Investment Enterprise Law restricts 10% of our net earnings in the PRC, up to a maximum amount equal to 50% of the total capital we have invested in the PRC. We have not experienced any significant liquidity restrictions in any country in which we operate and none are presently foreseen. However, foreign exchange ceilings imposed by local governments and the sometimes lengthy approval processes which some foreign governments require for international cash transfers may delay our internal cash movements from time to time.

Losing the services of our executive officers or our other highly qualified and experienced employees could adversely affect our business.

Our success depends upon the continued contributions of our executive officers, many of whom have many years of experience and would be extremely difficult to replace. We must also attract and maintain experienced and highly skilled engineering, sales and marketing and managerial personnel. Competition for qualified personnel is intense in our industries, and we may not be successful in hiring and retaining these people. If we lose the services of our executive officers or cannot attract and retain other qualified personnel, our business could be adversely affected.

Environmental liability and compliance obligations may affect our operations and results.

Our manufacturing operations are subject to a variety of environmental laws and regulations governing:

- o air emissions;
- o wastewater discharges;
- o the storage, use, handling, disposal and remediation of hazardous substances, wastes and chemicals; and

Edgar Filing: TECHNITROL INC - Form 10-Q

- o employee health and safety.

If violations of environmental laws should occur, we could be held liable for damages, penalties, fines and remedial actions. Our operations and results could be adversely affected by any material obligations arising from existing laws, as well as any required material modifications arising from new regulations that may be enacted in the future. We may also be held liable for past disposal of hazardous substances generated by our business or businesses we acquire. In addition, it is possible that we may be held liable for contamination discovered at our present or former facilities.

Page 35 of 41

We are aware of contamination at two locations. In Sinsheim, Germany, there is a shallow groundwater and soil contamination that is naturally decreasing over time. The German environmental authorities have not required corrective action to date. In addition, property in Leesburg, Indiana, which was acquired with our acquisition of GTI in 1998, is the subject of a 1994 Corrective Action Order to GTI by the Indiana Department of Environmental Management. The order requires us to investigate and take corrective actions. Monitoring data is being collected to confirm and implement the corrective measures. We anticipate making additional environmental expenditures in future years to continue our environmental studies, analysis and remediation activities. Based on current knowledge, we do not believe that any future expenses or liabilities associated with environmental remediation will have a material impact on our operations or our consolidated financial position, liquidity or operating results; however, we may be subject to additional costs and liabilities if the scope of the contamination or the cost of remediation exceeds our current expectations.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in market risk exposures that affect the quantitative and qualitative disclosures presented in our Form 10-K for the year ended December 28, 2001.

Item 4: Controls and Procedures

Within the 90 day period prior to the filing date of this report, we carried out an evaluation, under the supervision and with the participation of Company management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer have concluded that our disclosure controls and procedures are effective.

There were no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date of their evaluation.

Page 36 of 41

PART II. OTHER INFORMATION

| | | |
|--------|---|------|
| Item 1 | Legal Proceedings | None |
| Item 2 | Changes in Securities and Use of Proceeds | None |

Edgar Filing: TECHNITROL INC - Form 10-Q

| | | |
|--------|---|------|
| Item 3 | Defaults Upon Senior Securities | None |
| Item 4 | Submission of Matters to a Vote of Security holders | None |
| Item 5 | Other Information | None |
| Item 6 | Exhibits and Reports on Form 8-K | |

(a) Exhibits

The Exhibit Index is on page 38

(b) Reports On Form 8-K

We filed a current report on Form 8-K dated August 9, 2002. This report pertained to our voluntary compliance with the Securities and Exchange Commission's Order No. 4-460.

Page 37 of 41

Exhibit Index

Document

- 3.1 Amended and Restated Articles of Incorporation of the Company (incorporated by reference to Exhibit 1 to the Company's Registration Statement on Form 8-A/A dated April 10, 1998).
- 3.2 Amendment to Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3(i)(a) to the Company's Form 10-Q for the quarter ended June 29, 2001).
- 3.3 By-laws (incorporated by reference to Exhibit 3.3 to the Company's Form 10-K for the year ended December 28, 2001).
- 4.1 Rights Agreement, dated as of August 30, 1996, between the Company and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 3 to the Company's Registration Statement on Form 8-A dated October 24, 1996).
- 4.2 Amendment No. 1 to the Rights Agreement, dated March 25, 1998, between the Company and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form 8-A/A dated April 10, 1998).
- 4.3 Amendment No. 2 to the Rights Agreement, dated June 15, 2000, between the Company and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 5 to the Company's Registration Statement on Form 8-A/A dated July 5, 2000).
- 99.1 Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification of Principal Financial Officer, pursuant to 18 U.S.C, Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Technitrol, Inc.

(Registrant)

November 7, 2002

/s/ Drew A. Moyer

(Date)

Drew A. Moyer
Vice President
Corporate Controller and Secretary
(duly authorized officer, principal
financial and principal accounting
officer)

CERTIFICATION

I, James M. Papada, III, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Technitrol;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of Technitrol as of, and for the periods presented in this quarterly report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

Edgar Filing: TECHNITROL INC - Form 10-Q

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of The registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 7, 2002

/s/ James M. Papada III

James M. Papada, III
Chairman, President and CEO

Page 40 of 41

CERTIFICATION

I, Drew A. Moyer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Technitrol;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of Technitrol as of, and for the periods presented in this quarterly report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

Edgar Filing: TECHNITROL INC - Form 10-Q

- c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of The registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Drew A. Moyer

Date: November 7, 2002

Drew A. Moyer
Vice President, Corporate Controller and Secretary